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The Role of Trust in Effecting the Firm Performance and Human Capital to Earning Quality with Trust for Indonesia, Philippines and Thailand Banks

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Abstract

This study investigates the influence of firm performance and human capital on the earnings quality with trust as moderating variable, uses an internal factors as a predictor of earnings quality, the population of this research are listed banks in Indonesia, Thailand and Philippines on 2010-2014 period. Earnings quality is measured by Thomson Reuter. The Firm performance is measured by a proxy for earnings asset securities and reinvestment rate (Maherani et al., 2014). Human capital is measured by a proxy of total labor costs divided by net interest income (Mojtahedi, 2013). The results showed that firm performance and significant positive effect on the earnings quality. Human capital proved positive and significant impact on the earnings quality and trust proved to be a good moderating variable and the results also provide implications such as (1) customer acceptance, it can be used as new measurement for firm performance and earning quality, and (2) trust as additional indicator for banking regulation by Financial Regulator.

Keywords: firm performance, human capital, trust, earnings quality

Background

In 2008, Indonesia had a globalization crisis and got impacted, especially in banking business. Several years later, the impact was felt in Indonesian banking, local bank becoming a foreign banks such as, Maybank, CIMB Niaga, Bank Permata, Bank Danamon and Bank OCBC NISP, etc. Since the non-performing loans shows that the allowance for uncollectible bank receivables in earning assets (PPAP) has been increasing due to the decreasing of earnings quality. The main reason of banks transfer ownerships indicates that the previous bank owners had less of the capability in capital to fulfill the outstanding obligations for the third party, so they decided to sell to the new investors. The inability to fulfill the obligations of previous owners shows that the quality of profit generated in the firm operations is too low.

In banking industries, earnings quality is an important indicator for decision makers such as investors and bank authorities as regulators. There are a lot of researchers in the quality of earnings in various industries, but there is a limited researcher in the cross-state banking industries. The banking industries is a strict regulatory industries, the researcher may reveals the quality of profit in the banking industries to contribute. Bank business is a trust institution for customers, reflecting in Indonesia's banking crisis that had begun in 1997, banks are encouraged to improve the capability in managing the third party funds where's there is no deviation in lending. This study aims to test the firm performance and human capital on the earnings quality in the banking industries in three ASEAN countries which are, Indonesia, Philippines and Thailand.

Facing a MEA, where Thailand banking industries showed a good progress, with the limited banks, for examples Bangkok Bank as an international bank with the non-performing loans ratio (NPL) is considered higher with 2.4% compared to Indonesia banks with the 1.9%, unlike the condition of Thailand and Philippines banks, Indonesia's banks is considered not to be able to compete optimally. In the rank of ten largest banks in ASEAN countries, Indonesia's bank only has a Mandiri Bank, the rest of the banks such as BRI Bank and BCA Bank are grouped in 20 (twenty) largest banks and there are great opportunities to increase the capability and growth of Indonesia's positive nominal gross domestic product (GDP) and per capita income, which is experiencing fairly stable growth based on world bank data in 2013. Indonesia's banks have a pretty good capital to compete in the MEA with Mandiri Bank as one of the banks listed in the Top 500 Banking Brands and selected by the brand valuation of US \$ 1.658 billion, this value is smaller than the brand valuation of Thailand and Philippines banks (Gunawan, 2014).

Banks operations are running in the trust between bank management and customers, trust, and confidence in the quality and reliability of banking services is known as trust (Garbarino & Johnson, 1999). The longevity and success of a long-term relationship is influenced by trust existence (Patrick, 2002). All economics transactions including with a trust (Arrow, 1972) and public confidence can be a predictor of corporate sustainability (Putnam, 1993; Fukuyama, 1995), the results show the trusts effecting the accrual quality, low financial reporting errors and low disclosures of internal control materials (Garrett, Hoitash & Prawitt, 2014) and employees confidence in managers may have a positive effect to the quality of financial reports published. (Jollineau, Vance & Webb, 2012).

1. Literature review

Signaling theory suggests that market signals such as an activity or individual attributes in the market can alter or increase the confidence of information (Spence, 1974). Firm performance is especially important compared to competitors because investors and creditors compare the financial performance of competitors so as to determine the decision to allocate their capital (Maherani et al., 2014). The signaling theory said that firm performance may become a signal for investors for measuring the firm success, the firm in the future prospects and firm performance can be informed and monitored by the investors, which can be convincing for the investors and/or stakeholders to invest.

Successful growth and sustainability are influenced by existing resource empowerment and new resource development. The Resource-Based View Theory (RBVT) theory suggests that firm's achievements hold a sustainable comparative advantage and more benefit, and also have long-term performance and excel in compete when owning or controlling tangible and intangible assets strategically. In addition, RBVT's theory emphasizes the role of resources in creating value for the company as long as the resources are maintained and upgraded. The inherent value of human resources is called human capital - intellectual capital that can be measured through the account in the company's financial statements.

Human Capital is a skill, expertise, problem-solving ability, leadership style, and all things related to employment (Brooking, 1996). Ulrich & Lake (1990) states that human capital is an important dimension in the dynamic of corporate life associated with its strategic role as a company asset and manager of other assets. The linkage between human capital and earnings quality is based on several things. First, users of financial statements consider the reputation of management leaders as key in assessing the quality of financial reporting. Second, the chief financial director's quality may influence the company's financial reporting decisions. Third, there is an indication that managers who are identical with earnings management tend to report high profits to the market in order to maintain their reputation (Mojtahedi, 2013).

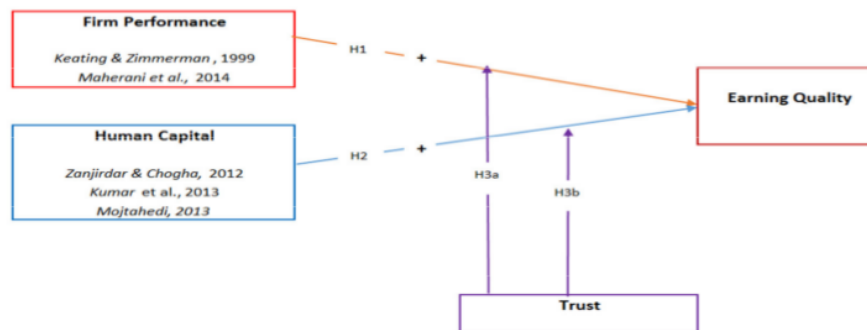


Figure 2.2
 Framework Idea

2.1. Hypothesis development

2.1.1. The Effect of Firm Performance on the Earnings Quality

The firm performance is an indicator of the level of achievement and reflects the success of management or the firm performance is the result of the company's expected behavior of the people in it (Gibson, 1998). The firm performance can be used by managers in implementing business strategies through a comparison between the actual results and strategic goals, it can be done in the short term period (less than or up to one year), while the measurement of long-term period including the ability for innovation and adaptation to change during a period of one year. Every public and private company is in need of performance appraisal system to ensure the company's goal is achieved efficiently and effectively. Achievement of the company requires the information on determining the performance indicators that are financial or non-financial.

Maherani et al., (2014) conducted a study on 63 Iranian companies over the period of 2002-2010. The empirical results show that firm performance has positive effect on earnings quality. This is because the profit is one of the criteria in assessing the performance of the company so that firm performance has a direct impact on improving earnings quality in the company (Maherani et al., 2014).

Based on the results of previous studies above, this research propose the following,

H₁ : Firm performance has a positive impact to Earning Quality.

2.1.2. The Effect of Human Capital on the Earnings Quality

Resource-based theory states that the company has the resources useful in improving competitive advantage and gets a good long-term performance. Optimal management of intangible assets that can help the company

achieved a competitive advantage.

The link of human capital and earnings quality can be described as follows; first, users of financial statements to consider reputation management as a key leader in assessing the quality of financial reporting. Second, the quality chief financial director (chief financial directors) may affect the company's financial reporting decisions. Third, there is an indication that the manager is identical to earnings management, tend to report higher earnings to the market in order to maintain its reputation (Mojtahedi, 2013). Proven in Joia's research (2000) showed no association of human capital and the quality of earnings can be accepted logically and empirically proven.

Human capital plays a fairly strong in improving the company's ability to develop and have a competitive advantage. Baum & Silverman (2004) showed that human capital affect the decision of corporate financial risk and performance of the company on bio-technology industry in Finland and its impact on firm performance in the future. The accumulation of productive human capital embodied in human immaterial will increase the productivity of their owners, and function as well in the labor market, this will usually result an increase in profits (Griliches, 1979; Weiss, 1986).

Mojtahedi (2013) examined the effect of human capital on earnings quality was conducted on 100 companies in Malaysia for the period of 2010-2011. The empirical results show that human capital has positive effect on earnings quality. These linkages show that both, growing level of knowledge and experience of executive management (as a proxy for human capital) have a relationship that, "the better they can manage accruals, the quality of earnings increase".

Based on the results of previous studies above, this research propose the following,

H₂ : Human Capital has a positive impact to Earning Quality.

2.1.3. **1.8** *The Role of Trust in Relation to the Firm Performance and Human Capital on Earnings Quality*

2.1.3.1 *The Role of Trust in the Effect Firm Performance to Earnings Quality.*

Trust plays an important role in organizational performance for a particular party will accept the consequences of any losses which the parties have great expectations of the outcome or the positive performance (Paliszkievicz, 2012). Trust holds a crucial role in the performance of the organization as an important factor in a variety of matters relating to aspects of organizational performance (Yu and Choi, 2014). In the study Wong et al., (2002), the existence of a positive relationship between organizational performance and trust which shows that the company's performance positively correlated with trust.

Maheerani et al., (2014) states that companies with low performance, the quality of the company's profit were also lower. Garrett, Hoitash & Prawitt (2014) showed that trust affects the quality and the low accrual financial reporting errors and lack of disclosure of material internal control.

Improved quality of financial reporting showed improvements in the quality of earnings in the company and vice versa. The quality of high profit shows that the company's earnings are relevant to the specific decisions made by decision-makers specifically reflected in the financial statements that either (Dechow et al., 2010; Ferrero, 2014), then it can be concluded that the trust also affect earnings quality. The positive correlation between trust and firm performance showed a synergy of both in improving the quality of earnings.

Based on the results of previous studies above, this research propose the following,

H_{3.1} **8** : Trust moderating the effect of Firm performance on Earnings Quality

2.1.3.2 *The Role of Trust in the Effect of Human Capital on Earnings Quality*

Trust is an intangible asset that is powerful in the development of work culture collaborative. On the side of organizational renewal, trust is a motivating force for individual internal. Effect, meaning, and consequences of trust affect the individual and the organization. Leadership is the ability to trust a leader in developing human capabilities to the vitality and competitiveness of the organization (Savolainen & Lopez-Fresno, 2013).

Trust presents an opportunity to gain access to valuable knowledge (political, economic) and relational resources. In the long term, the company of human relationships, social and cultural rights can be a competitive advantage (Savolainen, 2011). In the study Dirks and Ferrin (2002), found that the trust has an important role in employee attitudes and behavior as a positive working attitude and desire to cooperate.

The studies above shows that the trust has a correlation with human capital and it means both the growing level of trust will encourage the action of knowledge sharing (sharing knowledge) so as to develop human resources in the organization.

Mojtahedi (2013) examined the effect of human capital on earnings quality was conducted on 100 companies in Malaysia for the period of 2010-2011. The empirical results show that human capital efficiency has positive effect on earnings quality. Garrett, Hoitash & Prawitt (2014) showed that trust affects the quality of accruals, poor financial reporting errors, and poor disclosure of material internal control.

Improved quality of financial reporting showed improvements in the quality of earnings in the company and vice versa. The quality of high profit shows that the company's earnings are relevant to the specific decisions made by decision-makers specifically reflected in the financial statements that either (Dechow et al., 2010;

Ferrero, 2014), then it can be concluded that the trust also affect earnings quality. The positive correlation between trust and human capital showed synergy both variables in improving the quality of earnings.

Based on the results of previous studies above, this research propose the following,

H_{3.2} : Trust moderating the effect of Human Capital on Earnings Quality

12 3. RESEARCH METHODS

3.1 Population and Sample

The population in this study uses data bank issuers and has been listed on the stock exchange, namely, Indonesia, Philippines and Thailand for the period of financial statements and annual reports published from 2010 to 2014, the sample is selected with purposive sampling method with a sample frame as follows,

- Bank issuers listed on a stock exchange Indonesia, Philippines and Thailand up to December 31, 2014.
- Banks that have a minimum market capitalization of USD \$ 1,000,000.00 (one million United States dollars) for 2010 to 2014 period, so that there is equality within the quality of the stock market capitalization among the banks.

Based on this frame sample, obtained 31 banks covering,

Table 3.1 Total Sample Research

	Indonesia	Philippines	Thailand	Total
Number of bank issuers	41	15	11	67
Capitalization of < \$ 1 million	29	6	1	36
The research sample	12	9	10	31

Sources: Primary data are processed

The study population was issuer's bank in Indonesia, Philippines and Thailand with a total of 67 issuers representing 41 listed banks in Indonesia, 15 listed banks in Philippines and 11 listed banks in Thailand. Among the listed companies, there are bank issuers having market capitalizations of less than \$ 1 million by 36 issuers. Total sample into 31 bank issuers are 12 listed banks in Indonesia, 9 (nine) listed banks in Philippines and 10 listed banks in Thailand.

3.2 Research Variables and Measurement

This study uses the independent variable is the quality of earnings as well as two independent variables, which are the firm performance and human capital as well as the moderating variable trust.

Table 3.2 Summary of Research Variables and Measurement

No	Variable	Scale	Proxy
1	Firm Performance Maherani et al., (2014)	Ratio Ratio	Securities Earnings Asset (SA) <i>Average Earnings Asset divided Average Total Asset</i> Reinvestment Rate (RR) <i>(Increased in fixed assets + Increased in working capital) divided (net income + non-cash expenses - non cash sales - dividend)</i>
2	Human Capital Mojtahedi (2013)	Ratio	Total Labor Cost (LC) <i>Total Labor Cost = (total personal cost included BOD & BOC + all allowances - pension allowance - personal income tax) divided Total net interest income</i>
3	Trust Thomson Reuters	Ratio Ratio	Customer Acceptance (CA) <i>Increasing number of customers based on yearly calculation</i> Deposit Growth (DG) <i>(Total Current Deposit divided Total Previous Deposit) * 100%</i>
4	Earning Quality Thomson Reuters	Ratio	Earning Quality <i>Accrual component, cash flow component, operating efficiency component & exclusions component</i>

3.3 Data Analysis Method

Data analysis process uses a multiple regression to conduct an empirical verification. This method will directly test the effect between independent variables and dependent variable. Beside that, this method also testing the

moderate variable in that relations. To support this method, this research will be testin the empirical data using SPSS 19.

4. DISCUSSION AND ANALYSIS

4.1 Classic Assumption Test

For the sample of the research, it will be using bank issuers that are listed on a stock exchange in Indor¹⁴ a, Philippines and Thailand until December 31, 2015 and the bank has a market capitalization of at least USD \$ 1,000,000.00 (one million United States dollars) for the period of 2010 to 2014, assuming equality of the qual¹⁵ of the stock market capitalization among the banks that have to do research.

This study used secondary data derived from the financial statements and annual reports of 31 banks (listed banks) from three countries, namely Indonesia, Philippines and Thailand, and then use the financial statements and annual reports published in the period of 2010 to 2014 and gained 155 firm to do fu¹er observation. The aim of research to test the hypothesis of the influence of independent variables, namely the firm performance and human capital against the independent variable is earnings quality with moderating variable trust,⁴

Descriptive Statistics show that SA has the lowest value of 0.006 and the highest value of 0.797 with a standard deviation of 0.430 (smaller than the mean value of 0.202). RR has the lowest value of 0.000 and the highest value of 0.309 with a standard deviation of 0.461 (smaller than the mean value of 0.117). LC has the lowest value of 0.134 and the highest value of 0.413 with a standard deviation of 0.453 (smaller than the mean value of 0.233). CA has the lowest value of 0.000 and the highest value of 0.119 with a standard deviation of 0.014 (greater than the mean value of 0.007). DG has the lowest value of -0.219 and the highest value of 0.575 with a standard deviation 0.128 (smaller than the mean value of 0.132). EQ has the lowest value of 0.010 and the highest value of 0.950 with a standard deviation of 0.265 (smaller than the mean value of 0.495).

The study is in the test for normality using the Kolmogorov method Smirnov (KS), that the data in the analysis model is said to follow a normal distribution if the value is smaller than the arithmetic KS table or the significance value greater than 5% alpha. (Steel, 1999). The test results with the Kolmogorov-Smirnov normality is 0.144, which means significant value greater than 0.05 so the normal distribution of data.

Multicollinearity testing using a VIF (variance inflation factors), double collinear (multicollinearity). The data in the analysis model is said does not happen multicollinierity if VIF is smaller than 10 (Myers, 1990), the test results showed that the regression model hypothesis does not have multicollinierity which can be seen from the VIF on each of the variable whose value is smaller than 10 and testing the assumptions multicollinearity have been met.

Heteroscedasticity variant testing was conducted to determine the diversity of research data. The test results Heteroscedasticity (presented in the appendix to this study) show that in the regression model examined not have a heterogeneous data, in other words all of the data shows the results already homogeneous and can be seen from the significant value of each of the independent variables is greater than 5 % (sig.> 0.05). Thus the regression model to be created as a research hypothesis has fulfilled assumptions Heteroscedasticity free.

22 Regression Analysis

Based on the results obtained from the regression H1 shows that the securities earning assets and reinvestment rate positive and significant impact on banks in Indonesia, Thailand and Philippines. The inter-state empirical results show that securities earning assets has significantly influenced earnings quality in Philippine²¹ and Thailand compared to Indonesia, is different in the company's performance proxy, reinvestment rate has a significant effect on Indonesia⁶

Based on the results of research from the regression H2, human capital (labor cost) positive and significant effect on the quality of earnings at banks located in Indonesia, Thailand and Philippines. Inter-state empirical results showed that labor cost proved to have a significant effect on earnings quality in Thailand and Indonesia compared to Philippines.

Based on the research results from the regression H3, Trust (customer acceptance) can strengthen the relationship between the performance of companies (reinvestment rate), human capital and earnings quality significantly. While trust (deposit growth) to strength the relationship among the firm performance (both securities asset earnings & reinvestment rate), human capital and earnings quality significantly. So we can conclude that the proxy trust deposit growth better as variables moderating the relationship between firm performance and earnings quality.

The inter-state empirical results show that securities earning assets have significantly influenced earnings quality by moderated by customer acceptance (CA) in Thailand compared to Philippines, Indonesia, where the firm performance proportion is reinvestment rate which has only significant effect on earnings quality with moderated by customer acceptance (CA) in Thailand compared to the Philippines, and Indonesia. In addition, the inter-state empirical results show that securities earning assets have been shown to significantly influence earnings quality by moderated by deposit growth (DG) in the Philippines and Indonesia compared to Thailand,

different in the firm performance proxy, only reinvestment rate have a significant effect on earnings quality by moderated by deposit growth (DG) in Thailand compared to Philippines and Indonesia.

The inter-state empirical results show that labor cost proved to significantly affect earnings quality by moderated by customer acceptance (CA) in Thailand compared with Philippines and Indonesia, different things for proxy trusts are deposit growth (DG) where labor cost has a significant effect on earnings quality by moderated by deposit growth (DG) in Indonesia compared to Philippines and Thailand.

1 CONCLUSION, IMPLICATIONS AND RECOMMENDATIONS

This study analyzes the influence of firm performance and human capital on the quality of earnings. Good firm performance can reduce the level of earnings management in the financial reporting of companies that produce good earnings quality (De Angelo et al., 1994). The quality of financial reporting is strongly influenced by the quality of human resources of the company. The better the company's human resources, the quality of high profits can be presented in the financial statements (Zanjirdar & Chogha, 2012). Due to the research carried out in the banking sector, it is necessary to consider the factor of trust as a moderating factor, where the level of customer confidence in the bank can determine the sustainability of the company and the company's revenue.

The results of the study provide input for researchers on a more specific measurement for the variable performance of the company (security earnings and asset reinvestment rate) and human capital (labor cost) in the sample relating to banking thus enriching the accounting literature in the field of banking. The results of this study show that customer acceptance (CA) and deposit growth (DG) has the strongest influence in strengthening the relationship between firm performance and human capital on the quality of earnings as compared to the proxy trust such as customer acceptance (CA). It's expected to encourage banks to disclose the customer data acceptance (CA) in yearly performance in annual report, so that it may be considerable for investors to analyze the condition of listed banks performances, in particular the quality of earnings.

The inter-state empirical results show that securities earning assets has significantly influenced earnings quality in the Philippines and Thailand, while reinvestment rate has a significant effect on Indonesia. Human capital (labor cost) proved to have a significant effect on earnings quality in Thailand and Indonesia.

The results of this study can provide new knowledge for regulators, in particular the Financial Services Authority (FSA) about the role of trust in the organization in strengthening the quality of earnings in the company that focuses on the bank so that the regulator can accommodate this deficiency in the form of new rules or revised legislation which exists.

For further research, it is recommended to add the observation period of more than five years and comparison samples can be taken from other countries.

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